



Economic and Strategy Viewpoint

September 2020

To all readers, we are moving to a quarterly publication schedule for the Economic and Strategy Viewpoint. Regular updates on our views and research pieces will be published in between and will be distributed directly. We hope this will enhance and increase the timeliness of our analysis in the



Keith Wade

Chief Economist and Strategist



Azad Zangana

Senior European Economist and Strategist



Piya Sachdeva

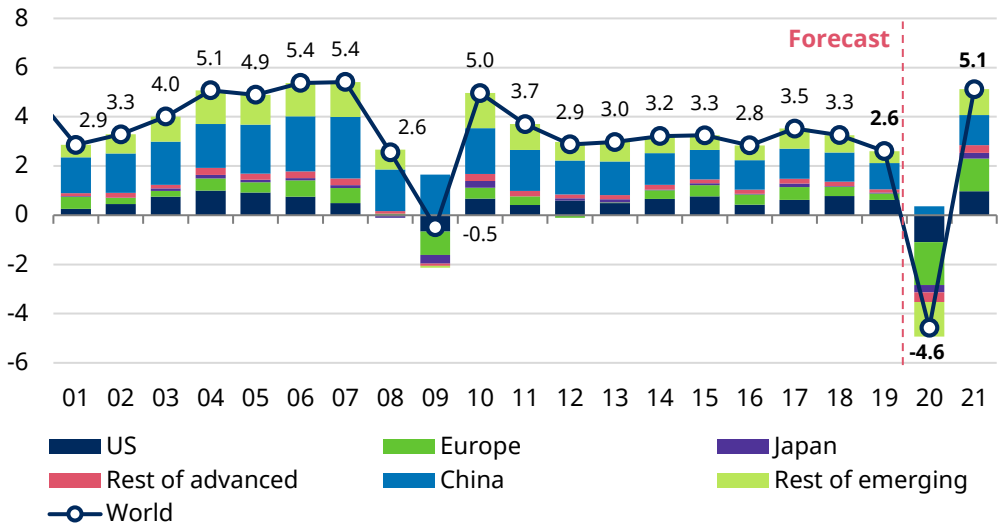
Japan Economist

Forecast upgraded, but risks remain

- Global GDP growth in 2020 has been upgraded to -4.6% from -5.4%, driven by a significant revision to the US after a better-than-expected performance in Q2. Near-term the forecast path for growth resembles a square root sign; overall it is still a U.
- Inflation is expected to remain subdued allowing central banks to keep policy loose with no rate rises in the forecast. However, we do see some easing in the pace of quantitative easing as growth continues through 2021.
- We anticipate a change in occupancy at the White House although Congress is expected to remain split after the election and limit the new President's room for maneuver on fiscal policy although international trade tensions may ease.
- We still see the risk of a second wave, but overall the balance of risks has shifted in a slightly more reflationary direction led by a switch in our scenarios and a continued chance of a V-shape recovery.

Chart: Contributions to global growth

Contributions to World GDP growth (y/y)



Source: Schroders Economics Group, August 10, 2020. Please note the forecast warning at the back of the document.

Forecast upgraded, but risks remain

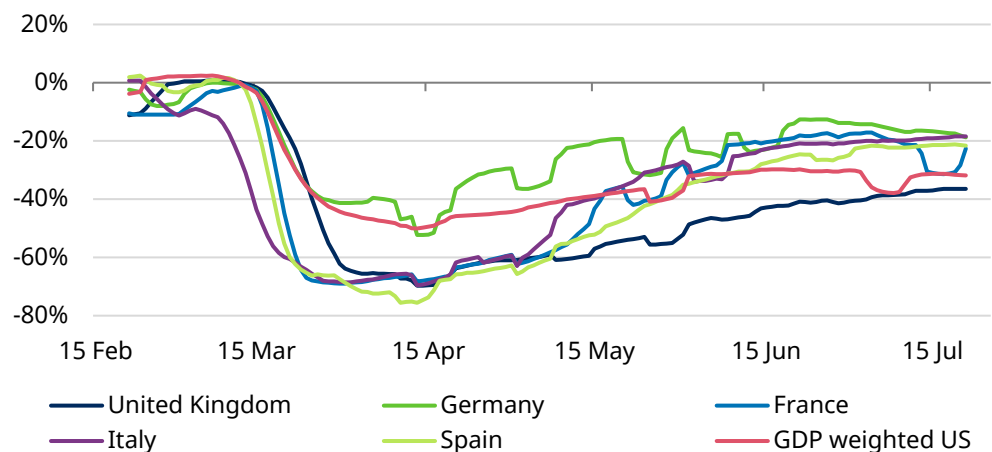
The recovery continues, but at a more moderate pace

Since our last forecast in May we have seen a further easing of lockdowns, particularly in Europe, and a gradual resumption of economic activity. The US has seen a second wave of outbreaks in the southern states and cases in India and Brazil continue to rise rapidly. The toll from Covid-19 continues to rise, but there are signs that the fatality rate is slowing, indicating that treatment of the virus is improving. For example, despite a rise in cases to a new high in the US at 65k/day, the fatality rate has not reached levels seen during the first wave of the outbreak.

High frequency data suggests that the recovery continues, but there are signs that the pace is slowing as can be seen in the mobility data (chart 1). After the initial burst of pent-up demand, there would inevitably be a moderation in spending. The goods sector was able to benefit from an easing of restrictions, but the service sector has found it more difficult to adjust to a world of social distancing and limits on the size of gatherings. For example, hotels, airlines and leisure businesses are restructuring with significant effects on employment.

Chart 1: Mobility data points to moderation in recovery

Deviation from baseline (3 Jan-6 Feb)



Source: Google, Schrodgers Economics Group. August 11, 2020.

Here are the main changes to our outlook:

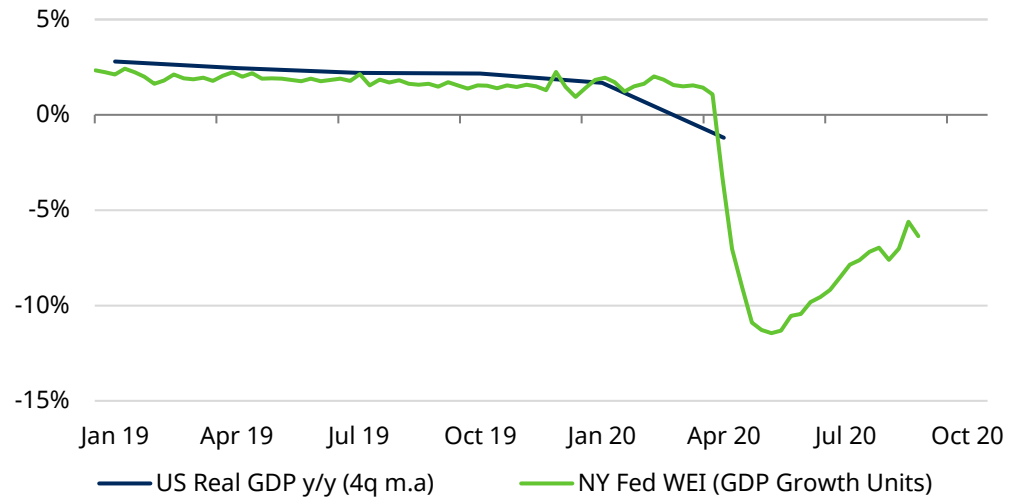
1. Global GDP growth upgraded

Global growth upgraded for 2020 following better-than-expected Q2

Global GDP growth in 2020 has been upgraded to -4.6% from -5.4%, driven by a significant revision to the US (from -8.2% to -4.1%) after a better-than-expected performance in Q2.

Our forecasts for Japan and the emerging markets have also been increased, whilst those for the eurozone and UK have been downgraded, largely as a result of the pattern of surprises in Q2. We expect a further recovery in Q3, before growth moderates in Q4. For the US the near term is in line with the Weekly Economic Index (WEI) produced by the New York Federal Reserve which is based on 10 daily and weekly indicators (chart 2).

Chart 2: US weekly economic index



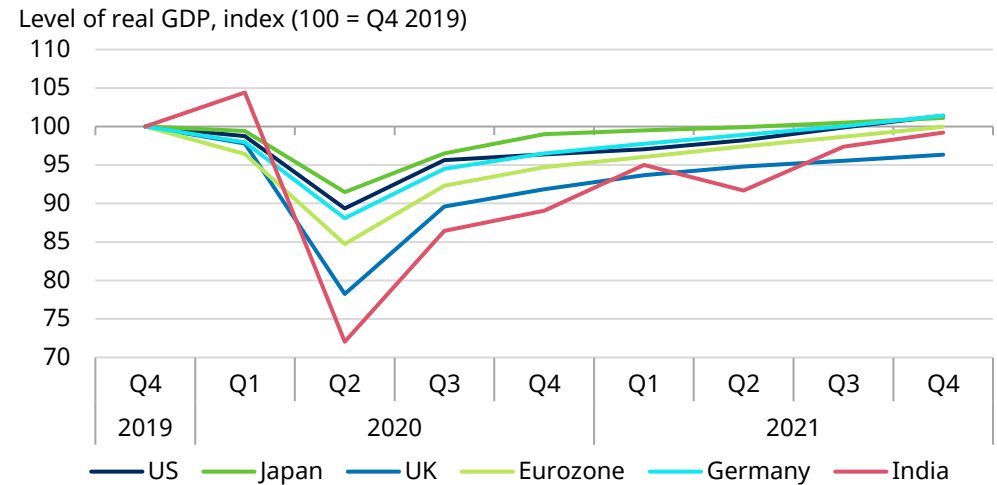
Source: New York Federal reserve, Schrodgers Economics Group. August 11, 2020.

In 2021, global growth should improve to 5.1% (previously 5.3%) supported by loose fiscal and monetary policy and the arrival of a vaccine at mid-year which is distributed in Q3. The latter is critical in overcoming business and consumer caution which is likely to hold back investment and consumption.

2. Near-term the forecast path for growth resembles a square root sign, overall it is still resembles a U

The path for growth is shown in chart 3 below for a range of countries. It is similar to our previous forecast which we described as a U-shape. However in the near term given the sharp rebound we have a V followed by a levelling off in activity – similar to the uptick on a square root sign.

Chart 3: Forecast path for selected countries



Source: Schrodgers Economics Group, August 10, 2020.

Trump to leave the White House

3. President Trump is expected to lose office to Joe Biden in the November election, but congress will remain divided

US growth receives a minor boost as a result. With the Senate remaining in Republican hands there is not the scope for a significant fiscal easing; however, a more multi-lateral approach to international relations should reduce uncertainty and boost growth globally. US-China tensions should ease somewhat as a result although remain high as China falls short of its phase 1 commitments on purchases from the US. The trade war between the two countries is likely to resume towards the end of 2021. We explore the consequences of a Democrat sweep in our scenarios below.

There is a possibility that the presidential election turns into a fiasco: Trump is already complaining that the high number of postal votes due to Covid-19 will result in electoral fraud. If so this could result in the election being declared invalid and Mr. Trump refusing to leave the White House. To help matters the newly appointed postmaster general has dismissed 23 senior executives and cancelled overtime, measures which will slow rather than speed the delivery of postal votes. We have not built such a scenario into our baseline, but it may become reality if the margin of victory is narrow. The effect would be to bring the economy to a halt as business and consumers put their plans on hold.

4. Inflation remains quiescent

We do see a slight pick-up in our global consumer price index (CPI) inflation forecast – as a consequence of firmer oil prices – to 1.8% in 2020 and 2.0% in 2021 (previously 1.5% and 1.8% respectively). However, the recovery in activity is not strong enough to close the output gap. For example, US unemployment persists above pre-Covid levels and is running at 6.8% at the end of 2021 (versus 3.2% in Q4 2019). Core inflation remains weak ending 2021 at 0.8%, well below the Fed's target of 2%.

5. Central banks continue with QE, although the pace moderates

Low inflation allows central banks to keep policy easy and we see no move in interest rates this year or next. Quantitative easing continues around the world with the result that the Fed balance sheet soars to \$9 trillion by the end of the forecast period. This is an increase of \$2 trillion from today; however, the pace of QE will moderate to around \$150 billion per quarter compared with its current pace of \$360 billion.

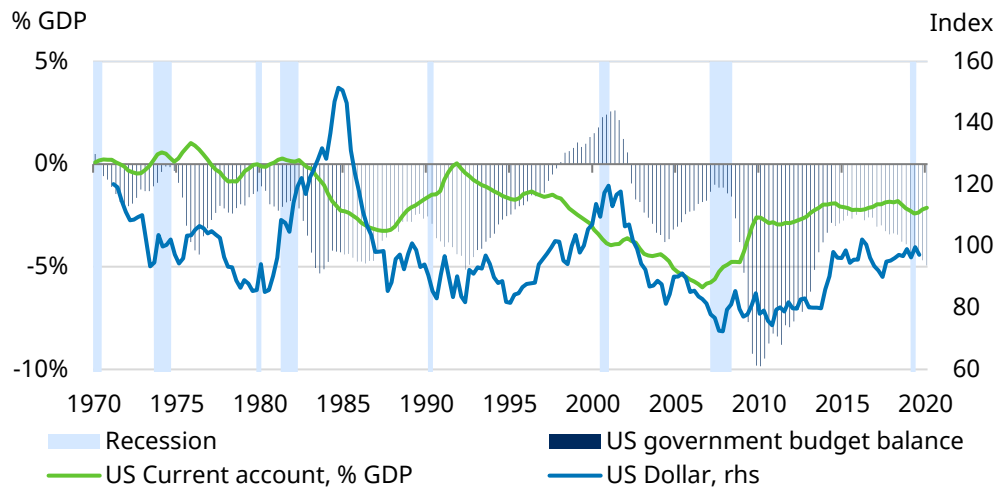
6. The US dollar weakens further

Two factors are expected to soften the dollar further. The first is the arrival of President Biden and the reduction in US-China tensions mentioned above which reduces the attraction of the US dollar as a safe haven. The second is the likely return of the twin deficits. The US budget deficit is on track to reach \$3.5 trillion or 17% of GDP this year and although it should narrow as economic activity recovers in 2021, the overall current account deficit will increase. Given that a significant portion of the budget deficit is structural (around 4% GDP) the US looks to be heading for a twin deficit problem which would herald a spell of dollar weakness as the economy becomes dependent on external funding (chart 4 on next page).

Central banks to keep liquidity flowing

US dollar will face a twin deficit problem

Chart 4: Another twin deficit problem for the US?



Source: Refinitiv Datastream, Schroders, G0198. August 11, 2020.

Regional views

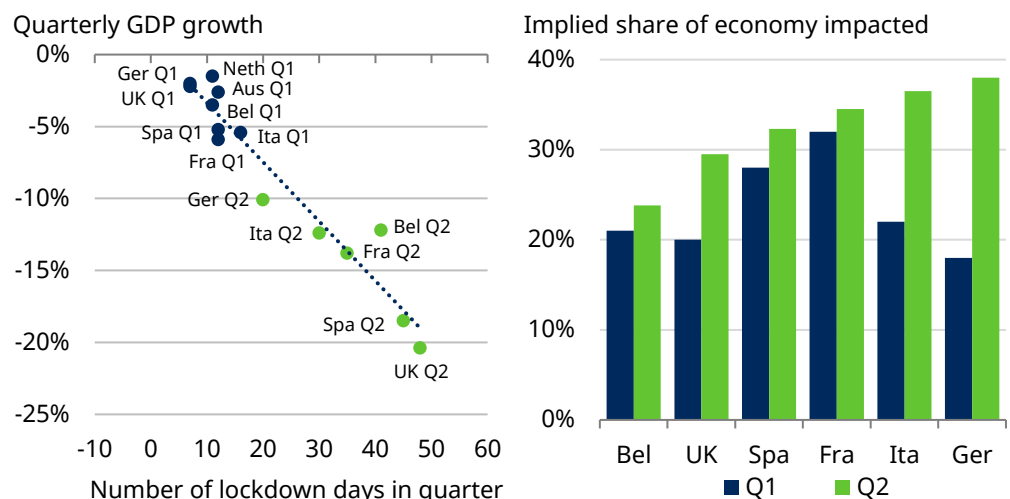
Europe

Our eurozone growth forecast has been revised down from -6.1% to -7.8% for 2020, largely due to a worse-than-expected outturn for the second quarter. Lockdowns were in place for longer than expected, but in addition, the implied share of economies affected rose compared to the first quarter. This is shown in charts 5 and 6, where the former plots quarterly GDP growth against the number of working days in lockdown during the quarter, while the latter shows the implied share of economies impacted.

Germany saw the largest increase in the severity of the economic shock as the implied share of its economy affected rose from 18% to 38% – from the lowest to the highest between Q1 and Q2. This may be because the external sector was largely unaffected in March, as it took longer for international trade to be impacted. German exports fell 21% in real terms in Q2 compared to just a fall of 3.3% in Q1).

Charts 5 and 6: Growth vs. lockdown duration

The economic impact from lockdowns intensified in Q2



Source: Refinitiv Datastream, Eurostat, Schroders Economics Group. August 13, 2020.

Italy also saw the impact of the pandemic on its economy intensify. GDP fell by 12.4% in Q2 compared to -5.4% in Q1. France and Spain also saw large contractions (-13.8% and -18.5% respectively), but the impact from lockdown was similar to that seen in the first quarter once adjusting for the number of days lost.

Lockdowns have largely been lifted, though some isolated outbreaks have triggered regional lockdowns. The Catalan region of Spain has been badly hit through August as the number of confirmed cases have risen to over 40% of the peak recorded at the end of March. This is likely to be the new norm, especially as temperatures fall in the autumn, allowing the virus to survive longer on surfaces.

For 2021, eurozone GDP has been revised up from 4.6% to 6.2%, partly due to the faster rebound expected following the deeper recession in 2020, but also partly in anticipation of the impact from additional fiscal stimulus, thanks to the milestone agreement to set up the EU recovery fund (also known as Next Generation EU). The €750 billion fund will be distributed from the second half of 2021, with most of the disbursement completed by 2023. The fund is worth 5.4% of EU GDP, and so should raise growth significantly over those years. For more see [“EU takes giant leap and edges towards fiscal union”](#).

As for inflation, while higher wholesale energy prices will help raise energy inflation, tax cuts are forecast to more than offset these effects. In particular, Germany has lowered its VAT rates, with the main rate lowered from 19% to 16% until the end of the year. Inflation is forecast to slow from 1.2% in 2019 to 0.3% in 2020, before rising to 1.1% in 2021.

ECB has expended its QE program, and is likely to do so again

At the start of June, the European Central Bank (ECB) increased the size of its quantitative easing program by €600 billion, and extended purchases into the middle of 2021 (for more, see [“ECB super-sizes asset purchases as deflation fears return”](#)). This appeared to be in response to increased borrowing forecasts from governments, and suggested that the ECB is keen to keep liquidity ample in sovereign markets. We therefore forecast a further €500 billion increase to keep purchases running until the end of 2021, which allows enough time for the disbursement of the EU recovery fund. The forecast assumes all interest rates to remain unchanged during the forecast horizon.

Lastly on the eurozone, it is also worth noting that political risk has fallen substantially over the quarter. The EU recovery fund paves over the cracks that are the terrible state of Italy's public finances, while the issue of the German Constitutional Court's challenge to the restart of QE appears to have passed, as the ECB spent a considerable amount of time this quarter justifying its actions.

UK

UK GDP revised down after poor Q2 reading, but recovery is underway

The UK GDP growth forecast has been downgraded from -8.5% to -10.4% for 2020, with 2021 revised up from +6.0% to +6.2%. Similarly to the eurozone, the main change to the forecast is driven by the new information we received from the Q2 GDP release. GDP fell by 20.4%, which based on about 48 working days of lockdown in Q2 meaning about 30% of the economy was impacted – up from 20% in Q1 (see chart 5 above). The UK is now confirmed to be in recession, although the monthly GDP series shows that the economy grew by 8.7% in June compared to April, which suggests a reasonably sharp rebound is likely in Q3. Yet, we only have GDP returning to its pre-crisis level in 2022 as some parts of the economy, particularly some services and retailers, are unlikely to be viable going forward.

The much heralded mini summer budget failed to excite, as approximately 1.4% of GDP worth of stimulus was announced, though much of it will not be realized. A bonus is being offered for firms to take back staff from furlough, yet for those considering laying off workers the bonus is too small to make a difference. However, the majority that planned to return to work as normal will welcome the poorly

The BoE has all but ruled out negative interest rates

targeted giveaway. The package also included a cut in VAT from 20% to 5% until mid-January 2021 for restaurants, accommodation and attractions, and a scheme to offer a limited discount for households dining in eateries. For more, see [“UK mini budget delivers minimal boost”](#).

The cut to VAT for the above mentioned sectors and discounted eating has led to a cut to the UK inflation forecast – lowered from 1% to 0.3% for 2020. As these discounts unwind, base effects will cause the annual comparison to rise to 1.7% next year. However, this has been downgraded from our previous forecast of 1.9%. This is due to our estimate of spare capacity increasing for 2021, caused by the GDP downgrade.

As for monetary policy, the Bank of England has kept policy unchanged, and is unlikely to make any significant changes over the forecast horizon. The August Monetary Policy Report (MPR) highlighted a bullish outlook in terms of GDP growth, and the committee’s joint view is that there is a greater than 50% chance that inflation will be above the Bank’s 2% inflation target by the end of the forecast period. This suggests that the BoE does not agree with current market pricing, which has interest rates falling into negative territory, and remaining there until 2027!

Indeed, the MPR includes a discussion on how negative interest rate policy would work, and it concludes that given the current situation, the blockages in the banking transmission mechanism would make the policy ineffective. A strong hint that interest rates will remain in positive territory, though the Bank does not rule out the use of negative interest rates in the (distant) future.

Japan

Less than a year ago, Tokyo was now expecting to be on the global stage hosting the Summer Olympics. But the mood is far from celebratory as the capital continues grapple with a second wave of the virus.

The economic recovery is underway and strong retail sales shows pent-up demand from households, helped by cash handouts from the government. But other data including, exports, industrial production and the PMIs show a Japanese recovery that is far from a ‘V-shape’. Strict employment law keeps unemployment under 3%, but do not be fooled: weakness in the labor market is clear with wages falling by over 2% y/y.

This quarter, we make three changes to the growth outlook. Firstly, we lower the expected economic damage from the lockdown in Q2 GDP as suggested by the monthly data. A lower fall in activity should result in a weaker bounce-back, so we also lower the near term recovery path. This also reflects that pent-up demand will be short-lived due to resurgence of the virus and subsequent local containment measures in addition to the weak recovery industrial sector, which is still suffering from the collapse in global trade. Finally on the positive side – though base effects mask this in the annual numbers – we see an improved export and capex outlook in the second half of 2021. This stems from a better trading relationship between the US and China.

A re-estimation of our inflation model results in an upward revision this quarter, but our message is the same; the inflation outlook is deflationary. In the near term, this is mainly due to a drag from energy and in 2021, due to lower core inflation from spare capacity. The Bank of Japan, will likely do its best to avoid changing yield curve control and instead focus on QE.

EM to benefit from reduced trade tensions and a weaker dollar

Emerging markets

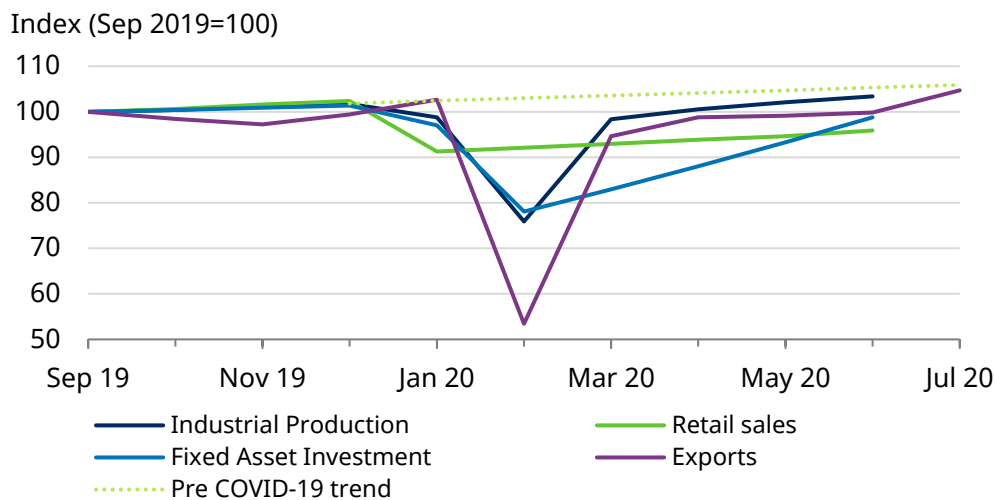
A significant positive surprise in India for growth in Q1 leads us to revise the emerging markets growth outlook higher to -2.7% in 2020. Looking forward, we expect China and India to continue to display very different trajectories in their recoveries, but lower the near term growth outlook for both economies. Finally, a weaker dollar and reduced trade tensions between the US and China should help the wider emerging markets, particularly in the second half of 2021.

China

'First-in, first out' from Covid-19, China returned to growth in the second quarter with GDP growth recovering faster than many forecasters' expected from -6.8% y/y to 3.2% y/y. Many market commentators are hailing China's V-shape recovery but it is difficult to assign the recovery just one letter. Industrial production has bounced back strongly – visually almost a perfect 'V-shape' – helped by a recovery in autos and high-value added manufacturing products. Meanwhile, the recovery in demand has lagged supply, particularly in the consumer sector as households remain cautious on spending. The recovery in retail sales, so far, looks like an 'L', and weak imports and a lower services PMI in July suggests this is set to continue. Supported by infrastructure and real estate investment, the recovery in fixed asset investment has been stronger. This has been gradual, perhaps closer to a 'U' but is still on track to hit the previous trend in the coming months.

Chart 7: The shape of the Chinese recovery

IP bounces back but retail lags



Source: NBS, CEIC, Societe Generale, Schrodgers Economics Group. August 10, 2020.

On the other hand, the export recovery – capturing the recovery in international demand – has been quite startling, with exports back to the pre-Covid-19 trend. This is promising for wider global trade, though we are wary of extrapolating given second lockdowns around the world and the significant amount of Chinese exports of Covid-19 related medical supplies.

This quarter, we tweak the Chinese growth outlook slightly lower by 0.1% to 2.1%. To an extent this captures second outbreaks of the virus, both at home and abroad, which should dampen activity somewhat. The weakness in demand relative to supply will likely result in destocking in the second half of the year, acting as a drag on growth. On the positive side, we upgrade next year's growth outlook to 7%, reflecting an improved trading relationship between US and China as a result of a Biden presidency.

We still expect inflation to fall this year, but by less than before as a result of higher oil and food prices. Then lower oil prices and a stronger currency lowers our expected path of inflation in 2021. With the economic recovery on track, less disinflationary pressure and concerns surrounding speculative bubbles, the People's Bank of China

(PBoC) has slowed the pace of easing. Given the recent guidance, we see less rate cuts than before, with the reserve requirement ratio (RRR) ending the year at 11% and 10% in 2021. On the fiscal side, the authorities retain the option of further fiscal stimulus if the recovery looks in jeopardy.

India

Balancing the economy and health outcomes has been especially tough in India. Cases are still on the rise passing the two million mark with no real end in sight. The virus is spreading to rural areas with little healthcare infrastructure and poor living conditions. More lockdowns in various states are taking their toll on the economic recovery. High frequency indicators such as mobility, electricity consumption, e-way bills (paid on the movement of goods), and the PMI are lower in July from June. This paints the picture of a stalling recovery.

With the government struggling from limited fiscal space, there has been only 1% GDP in new direct fiscal support and little new support has been signaled. There also constraints on monetary policy, but as inflation falls in the near term, we expect the support to come from the central bank in the form of another 25bps rate cut from the Reserve Bank of India (RBI) by the end of the year. Ongoing struggles with the virus and the restrained policy response will likely leave the level of GDP well below its pre-Covid-19 trend by the end of 2021.

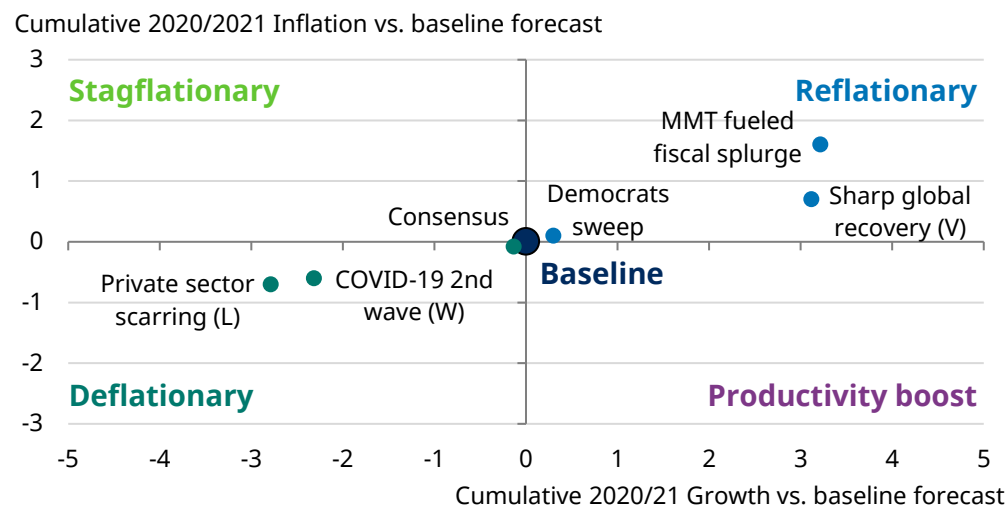
Scenario analysis

We have updated our scenarios to reflect the shifting balance of risks. The historic decision by the EU to set up a recovery fund to help the region overcome the impact of coronavirus offers much needed fiscal support and also marks a step toward fiscal union. Such co-operation combined with the ECB's decision to expand its QE program (the PEPP) means we no longer see a meaningful risk of a crisis in the eurozone and we drop this scenario.

We continue with the different letter shaped recoveries (V, W and L) and our MMT fueled fiscal expansion. In place of the Eurozone debt crisis we introduce a Democrat sweep scenario where the Democrats win the presidency and the Congress. This gives the new president more scope to expand fiscal policy and consequently results in a rise in growth and inflation compared to the baseline.

Full details of the scenarios can be found in the table at the back of the document (page 13). In terms of the impact on activity our scenario grid shows the variation in growth and inflation compared to our baseline (chart 8).

Chart 8: Scenarios growth and inflation vs. baseline forecast



Source: Schroders Economics Group, August 10, 2020.

Economy stalling as India struggles with the virus, expect more monetary easing

Euro risks evaporate with announcement of the EU recovery fund

Second wave W scenario is the greatest risk

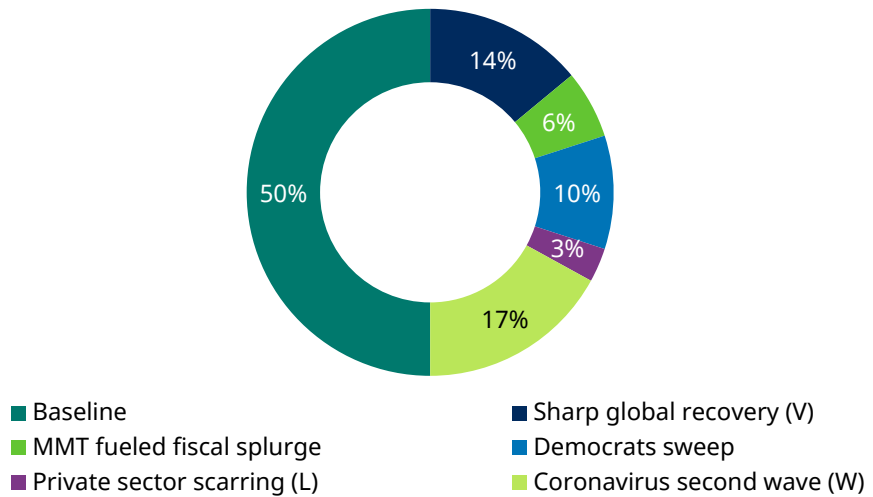
Our greatest risk scenario remains the W-shape second wave. There is evidence that as people are forced to spend more time indoors the virus spreads more rapidly. For example, recent heat waves in the Southern US or in Tokyo or Jerusalem have been followed by increases in the virus as people seek air conditioning. As the Northern hemisphere winter approaches there is an expectation that the incidence of the virus will rise as cold weather moves activity indoors.

The V-shape recovery still receives a relatively high probability and cannot be ruled out, but would require a working vaccine to be discovered by the end of the year. Recent news from Russia suggests that this may have been achieved, although the testing period has been remarkably short thus leaving doubts over its efficacy.

The Democrat sweep scenario also has a relatively high probability and would be in line with the betting odds such as PredictIt which attach a 60% probability to the Democrats winning the Senate. Note though that compared with our Covid-19 scenarios the variation in growth and inflation is considerably smaller.

Overall, taking account of our other two scenarios, the balance of risks has shifted in a slightly more reflationary direction led by the switch in our scenarios and a continued chance of a V-shape recovery.

Chart 9: Scenario probabilities



Source: Schroders Economics Group, August 10, 2020.

Schroders Economics Group: Views at a glance

Macro summary – August 2020

Key points

Baseline

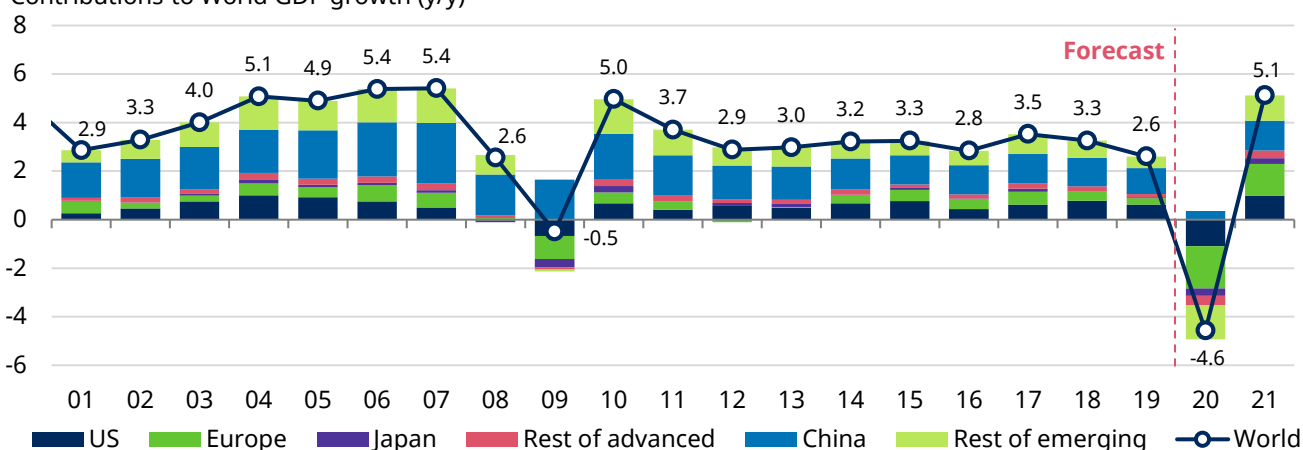
- Overall we see global activity falling 4.6% this year, less than our previous forecast of -5.4%, and is mainly driven by an upgrade to the US following a better than expected Q2. We continue to expect the recovery to be gradual as households and firms remain cautious. In 2021, global growth should improve to 5.1% as fiscal and monetary policy remain loose and on the medical front a vaccine is successfully developed by mid-year. Trump is expected to lose office to Biden in the US election and US-China tensions should ease slightly though remain high as China falls short of its phase 1 commitment on purchases from the US.
- US GDP is expected to fall by 4.1% in 2020, following a better than expected Q2. A smaller fall in activity results in a smaller bounce back, which is also hampered by the second wave in the southern states. Pent up demand should be short-lived and the recovery become more gradual to the end of the year. Despite fiscal stimulus, activity is not expected to return to its pre-covid level before end 2021. Lower oil prices and a significant output gap keep inflation below 2% over the forecast period allowing the Fed to keep interest rates at 0.25% (upper limit) and add more than \$1tn in QE, though the pace will likely slow in 2021 as the economy recovers.
- In the absence of second lockdowns, the eurozone continues its modest recovery in the second half of the year. Inflation is likely to fall below zero in the coming months, but average 0.3% over the year. This is driven mainly by lower energy prices, but also Germany's cut to its VAT rate for 2020. Inflation is forecast to then rise to 1.1% in 2021; sufficiently weak to keep ECB QE going through to the end of the forecast period, albeit with a slower pace of purchases. Interest rates are forecast to remain unchanged.
- Following a deep downturn, pent up demand helps UK growth recover in the second half of the year before rising 6.2% in 2021. The UK is expected to negotiate a partial free trade agreement with the EU covering some sectors that comes into force from 2021. Inflation is expected to fall to 0.3% in 2020 due to lower energy prices, various hospitality sector discounts including a VAT cut and weaker growth, but as the first two factors unwind, inflation rises to 1.7% over 2021. The BoE is forecast to keep interest rates on hold and increase QE purchases to £745bn.
- The second wave in Japan hampers the recovery in the near term, but fiscal support along with an upturn in the industrial cycle and recovery in global trade should help growth reach -4.6% in 2020. Domestic demand will likely remain soft as firms and households remain cautious. Meanwhile, the BoJ are expected to keep interest rates on hold and continue QE as inflation falls into negative territory.
- We expect an outright contraction in EM economies in 2020 of 2.7%. China's recovery should continue, led by the industrial sector. The weakness in demand relative to supply should result in some destocking at the end of the year but activity should recover further to 7% in 2021. We expect inflation of 3.6% in 2020 with weakness focused at the end of the year, unwinding only modestly in 2021. On the policy side, given concerns surrounding speculative bubbles, we see less rate cuts than before from the PBoC, with RRR ending the year at 11% and 10% in 2021.

Risks

- Though our largest risk scenario is COVID-19 second wave, the overall balance of probabilities are skewed in a reflationary direction, largely as a result of the sharp global recovery and democratic sweep scenarios.

Chart: World GDP forecast

Contributions to World GDP growth (y/y)



Source: Schroders Economics Group, August 10, 2020. Please note the forecast warning at the back of the document.

Schroders Forecast Scenarios

| Scenario | Summary | Macro impact | Cumulative 2020/21 global vs. baseline | | |
|---------------------------------------|--|--|--|--------|-----------|
| | | | Probability* | Growth | Inflation |
| Baseline | Global GDP growth in 2020 has been upgraded to -4.6% from -5.4%, driven by a significant revision to the US after a better than expected Q2. Our forecasts for Japan and the Emerging Markets have also been increased while those for the Eurozone and UK have been downgraded. The great lockdown took its toll on global activity in Q2, but economies recovered through the period as restrictions were eased. We expect further recovery in Q3 before growth moderates in Q4. In 2021, global growth should improve to 5.1% supported by loose fiscal and monetary policy and the arrival of a vaccine at mid-year which is distributed in Q3. President Trump is expected to lose office to Joe Biden in the November election. US-China tensions should ease somewhat as a result although remain high as China falls short of its phase 1 commitment on purchases from the US. Although constrained by a split Congress, Biden adds to growth through easier fiscal policy. On the inflation side, firmer oil prices push global inflation up slightly to 1.8% in 2020 and 2.0% in 2021. | The shock from Covid-19 will take time to heal and unemployment is expected to persist through the forecast period. Pre-covid19 levels of activity are not reached until end 2021 in the US and Eurozone with others taking longer. All economies are below their pre-covid19 expectations. Inflationary pressures are weak allowing monetary policy to remain easy. The Fed, ECB, BoE and BoJ are expected to keep interest rates on hold through the rest of 2020 and 2021 and continue quantitative easing. China is still forecast to lower its rates to 3.5% by the end of 2020 and to 3% by the end of 2021 while the RRR is expected to fall to 9% by the end of 2021. More fiscal stimulus is expected in light of the hit to growth and employment. The rest of EM is more constrained fiscally, though central banks will continue to cut rates to new lows. The USD is expected to weaken over the forecast period. | 50% | - | - |
| 1. Sharp global recovery (V) | Global growth rebounds sharply as a vaccine becomes available at the end of 2020 allowing activity to normalise. Fiscal and monetary policy prove more effective in boosting growth once economies open up. There is strong pent up demand from households with little evidence of scarring and government policies are successful in preventing output being lost permanently. This is the closest scenario to a "V shape" recovery. | Reflationary: Economies see output surpassing pre-COVID19 levels in the second half of 2021 and inflation also rises. In most countries, monetary policy is forced to tighten by the end of 2021 and fiscal policy support is reined in. | 14% | +3.1% | +0.7% |
| 2. MMT fueled fiscal splurge | With no other ammunition left, central banks begin to engage in Modern Monetary Theory (MMT), the direct monetary financing of government spending. Fiscal policy becomes much more aggressive, and while the ECB refrains from MMT, authorities join their counterparts in boosting fiscal spending. The additional fiscal stimulus help lift demand and in turn, the global economic recovery. | Reflationary: The rapid rise in money supply, combined with aggressive fiscal spending boosts growth and inflation. Inflation expectations rise and commodity prices spike with oil prices hitting \$100/ barrel as investors fearing inflation shift to the asset class. In turn, this pushes up producer prices and inflation to levels not seen in decades for most countries. US inflation peaks at over 4% in 2021. Monetary policy remains loose, but we would expect a change in personnel at the Fed and other central banks as policy moves in an unorthodox direction. No rate rises in the US, but with MMT QE is seen as unnecessary. The eurozone is the exception as the ECB is forced to hike in 2021. | 6% | +3.2% | +1.6% |
| 3. Democrats sweep | In November, the Democrats flip more than the four seats needed to win the Senate and they retain the House. With Biden winning the Presidency, the Democrats have a clean sweep enabling them to take full control of Washington. They quickly pass a big fiscal package to help the economic recovery and trade tensions between the US and China tensions ease. Biden avoids raising the corporate tax rate until 2022. | Reflationary: Fiscal stimulus boosts US growth by 0.6pp in 2021. Better growth, a weaker dollar and an improved trading relationship between the US and China has positive spill-over effects, boosting global trade helping growth in the rest of the world, including Emerging Markets. Better growth allows the Fed, the BoJ and ECB to slow the pace of QE, despite the latter dealing with disinflationary pressures from a stronger euro. | 10% | +0.3% | +0.1% |
| 4. Private sector scarring (L) | The development of a vaccine is delayed beyond the forecast horizon keeping households and firms cautious as economies experience outbreaks and lockdowns. Consequently, demand does not pick up as households decide to keep raising their savings in fear of a second wave. Firms, faced with structurally lower demand start to pull out of certain markets, as capex remains depressed. This is the closest scenario to an "L shape" recovery. | Deflationary: Despite the best efforts of fiscal and monetary policy makers, no amount of stimulus will lift demand. The world economy falls into secular stagnation and growth does not return to pre-Covid levels. Inflation falls close to 0% by the end of 2021 and the eurozone falls into deflation. | 3% | -2.8% | -0.7% |
| 5. COVID-19 2nd wave (W) | Economies re-open too quickly and a second outbreak of the virus at the end of 2020 prompts another wave of lockdowns. These are more targeted and localised and alongside better track and trace programmes, have a less severe impact than the first lockdowns. As a vaccine is developed in 2021, the global economy begins to recover in the second half of the year. This the closest scenario to a "W shape recovery". | Deflationary: Growth is very badly hit in 2020 and is 2.8ppt lower than the baseline. Inflation is also dragged lower owing to further weakness in demand and falling commodity prices. Global growth in 2021 is stronger than the baseline, but not enough to offset the hit from the previous year. Through this scenario, policy makers have no choice but to further loosen fiscal and monetary policy. | 17% | -2.3% | -0.6% |
| 6. Other | | | 0% | - | - |

*Scenario probabilities are based on mutually exclusive scenarios. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

| y/y% | Wt (%) | 2019 | 2020 | Prev. | Consensus | 2021 | Prev. | Consensus |
|-------------------------|--------|------|-------|----------|-----------|------|---------|-----------|
| World | 100 | 2.6 | -4.6 | ↑ (-5.4) | -4.7 | 5.1 | ↓ (5.3) | 5.2 |
| Advanced* | 61.4 | 1.7 | -5.7 | ↑ (-7.0) | -6.3 | 4.6 | ↓ (4.7) | 4.5 |
| US | 26.4 | 2.3 | -4.1 | ↑ (-8.2) | -5.3 | 3.7 | ↓ (4.8) | 4.0 |
| Eurozone | 17.6 | 1.2 | -7.8 | ↓ (-6.1) | -8.1 | 6.2 | ↑ (4.6) | 5.9 |
| Germany | 5.1 | 0.6 | -5.7 | ↓ (-4.5) | -6.3 | 5.3 | ↑ (3.7) | 5.1 |
| UK | 3.7 | 1.4 | -10.4 | ↓ (-8.5) | -9.2 | 6.2 | ↑ (6.0) | 5.9 |
| Japan | 6.4 | 0.7 | -4.6 | ↑ (-5.4) | -5.1 | 3.6 | ↓ (3.8) | 2.5 |
| Total Emerging** | 38.6 | 4.0 | -2.7 | ↑ (-2.8) | -2.3 | 5.9 | ↓ (6.4) | 6.2 |
| BRICs | 25.5 | 5.0 | -1.6 | ↑ (-2.2) | -0.9 | 6.6 | ↓ (7.4) | 7.1 |
| China | 17.5 | 6.1 | 2.1 | ↓ (2.2) | 1.7 | 7.0 | ↑ (6.9) | 7.9 |

Inflation CPI

| y/y% | Wt (%) | 2019 | 2020 | Prev. | Consensus | 2021 | Prev. | Consensus |
|-------------------------|--------|------|------|----------|-----------|------|----------|-----------|
| World | 100 | 2.5 | 1.8 | ↑ (1.5) | 1.6 | 2.0 | ↑ (1.8) | 2.1 |
| Advanced* | 61.4 | 1.4 | 0.6 | ↑ (0.4) | 0.5 | 1.1 | ↑ (0.8) | 1.3 |
| US | 26.4 | 1.8 | 1.1 | ↑ (0.6) | 0.8 | 1.4 | ↑ (0.8) | 1.8 |
| Eurozone | 17.6 | 1.2 | 0.3 | ↓ (0.4) | 0.4 | 1.1 | ↓ (1.3) | 1.1 |
| Germany | 5.1 | 1.3 | 0.3 | ↓ (0.6) | 0.6 | 1.5 | ↑ (1.4) | 1.5 |
| UK | 3.7 | 1.8 | 0.3 | ↓ (1.0) | 0.8 | 1.7 | ↓ (1.9) | 1.3 |
| Japan | 6.4 | 0.5 | -0.3 | ↑ (-0.9) | -0.2 | -0.4 | ↑ (-1.3) | 0.1 |
| Total Emerging** | 38.6 | 4.2 | 3.6 | ↑ (3.3) | 3.4 | 3.5 | ↑ (3.4) | 3.3 |
| BRICs | 25.5 | 3.3 | 3.2 | ↑ (2.7) | 2.9 | 2.7 | ↑ (2.6) | 2.5 |
| China | 17.5 | 2.9 | 2.9 | ↑ (2.8) | 2.7 | 2.1 | ↓ (2.2) | 1.9 |

Interest rates

| % (Month of Dec) | Current | 2019 | 2020 | Prev. | Market | 2021 | Prev. | Market |
|------------------------|---------|-------|-------|---------|--------|-------|---------|--------|
| US | 0.25 | 1.75 | 0.25 | (0.25) | 0.25 | 0.25 | (0.25) | 0.17 |
| UK | 0.10 | 0.75 | 0.10 | (0.10) | 0.08 | 0.10 | (0.10) | -0.03 |
| Eurozone (Refi) | 0.00 | 0.00 | 0.00 | (0.00) | -0.47 | 0.00 | (0.00) | -0.50 |
| Eurozone (Depo) | -0.50 | -0.50 | -0.50 | (-0.50) | - | -0.50 | (-0.50) | -0.50 |
| Japan | -0.10 | -0.10 | -0.10 | (-0.10) | -0.06 | -0.10 | (-0.10) | -0.03 |
| China | 4.35 | 4.35 | 3.50 | (3.50) | - | 3.00 | (3.00) | - |

Other monetary policy

| (Over year or by Dec) | Current | 2019 | 2020 | Prev. | Y/Y(%) | 2021 | Prev. | Y/Y(%) |
|-----------------------|---------|-------|-------|---------|--------|-------|---------|--------|
| US QE (\$Tn) | 4.0 | 4.2 | 8.1 | ↑ (5.7) | 92.9% | 9.0 | ↑ (5.9) | 11.1% |
| EZ QE (€Tn) | 2.4 | 2.4 | 3.3 | ↓ (3.5) | 37.5% | 4.6 | ↑ (3.8) | 39.4% |
| UK QE (£Bn) | 422 | 435 | 745 | (745) | 71.3% | 745 | (745) | 0.0% |
| JP QE (¥Tn) | 557 | 573 | 739 | ↑ (694) | 28.9% | 829 | ↑ (734) | 12.2% |
| China RRR (%) | 13.50 | 13.00 | 11.00 | ↑ 9.00 | - | 10.00 | ↑ 9.00 | - |

Key variables

| FX (Month of Dec) | Current | 2019 | 2020 | Prev. | Y/Y(%) | 2021 | Prev. | Y/Y(%) |
|--------------------------------|---------|-------|------|----------|--------|------|----------|--------|
| GBP/USD | 1.30 | 1.32 | 1.30 | ↑ (1.26) | -1.9 | 1.34 | ↑ (1.28) | 3.1 |
| EUR/USD | 1.18 | 1.12 | 1.20 | ↑ (1.10) | 6.9 | 1.22 | ↑ (1.08) | 1.7 |
| USD/JPY | 105.9 | 108.7 | 105 | ↓ (107) | -3.4 | 107 | (107) | 1.9 |
| EUR/GBP | 0.90 | 0.85 | 0.92 | ↑ (0.87) | 8.9 | 0.91 | ↑ (0.84) | -1.4 |
| USD/RMB | 6.98 | 6.97 | 7.10 | ↓ (7.21) | 1.9 | 7.10 | ↓ (7.50) | 0.0 |
| Commodities (over year) | | | | | | | | |
| Brent Crude | 44.5 | 64.2 | 43.0 | ↑ (35.9) | -33.0 | 46.0 | ↑ (36.4) | 7.0 |

Source: Schroders, Thomson Datastream, Consensus Economics, August 2020

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.

Market data as at 04/08/2020

Previous forecast refers to May 2020

* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.

** **Emerging markets:** Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan SAR, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

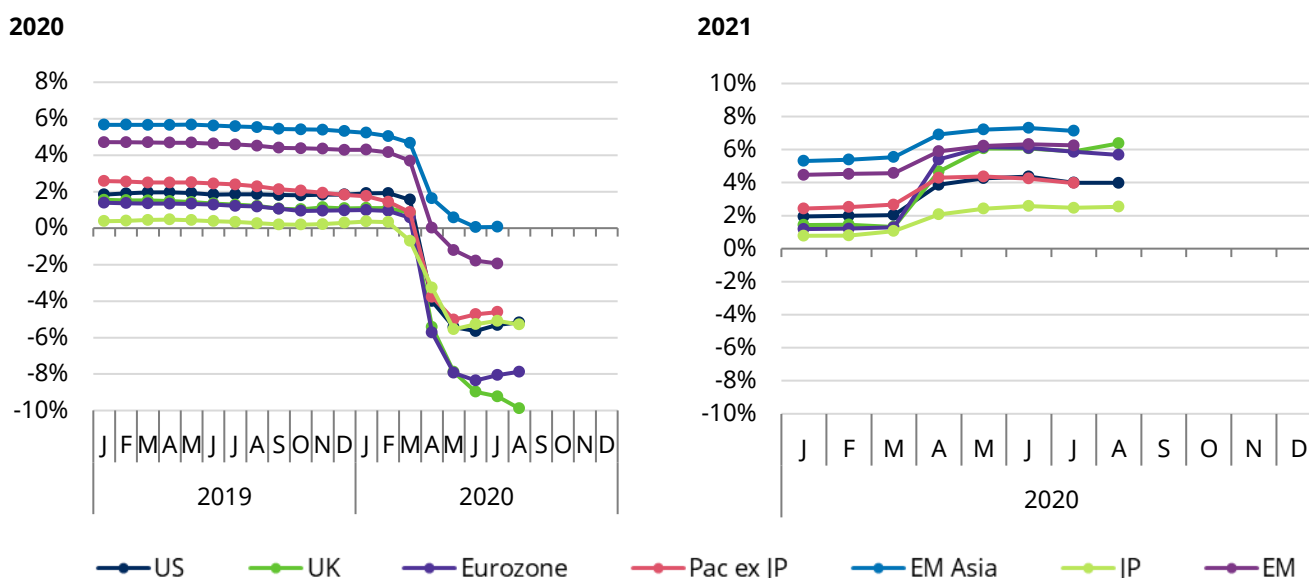
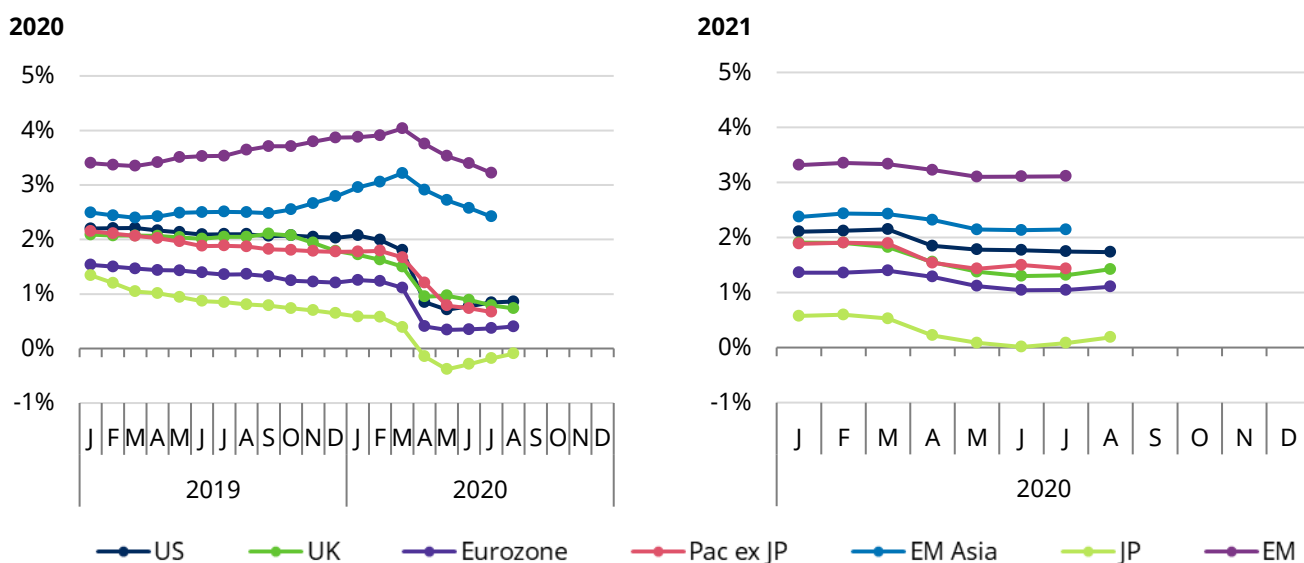


Chart B: Inflation consensus forecasts



Source: Consensus Economics (August 17, 2020), Schroders.

Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.

Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.

Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

The views and opinions contained herein are those of Schroders' Economics team, and may not necessarily represent views expressed or reflected in other Schroders communications, strategies or funds. This document is intended to be for information purposes only and it is not intended as promotional material in any respect. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. Information herein is believed to be reliable but Schroders does not warrant its completeness or accuracy. Reliance should not be placed on the views and information in the document when making individual investment and/or strategic decisions. Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get back the amount originally invested. The opinions included in this document include some forecasted views. We believe that we are basing our expectations and beliefs on reasonable assumptions within the bounds of what we currently know. However, there is no guarantee that any forecasts or opinions will be realised.

Schroder Investment Management North America Inc.

7 Bryant Park, New York, NY 10018-3706

[schroders.com/us](https://www.schroders.com/us)

[schroders.com/ca](https://www.schroders.com/ca)

Important information: The views and opinions contained herein are those of Keith Wade, Chief Economist and Strategist, Azad Zangana, Senior European Economist and Strategist and Craig Botham, Emerging Market Economist and do not necessarily represent Schroder Investment Management North America Inc.'s house views. These views are subject to change. This newsletter is intended to be for information purposes only and it is not intended as promotional material in any respect. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument mentioned in this commentary. The material is not intended to provide, and should not be relied on for accounting, legal or tax advice, or investment recommendations. Information herein has been obtained from sources we believe to be reliable but Schroder Investment Management North America Inc. (SIMNA Inc.) does not warrant its completeness or accuracy. No responsibility can be accepted for errors of facts obtained from third parties. Reliance should not be placed on the views and information in the document when taking individual investment and / or strategic decisions. The information and opinions contained in this document have been obtained from sources we consider to be reliable. No responsibility can be accepted for errors of fact obtained from third parties. The opinions stated in this document include some forecasted views. We believe that we are basing our expectations and beliefs on reasonable assumptions within the bounds of what we currently know. However, there is no guarantee that any forecasts or opinions will be realized. SIMNA Inc. is registered as an investment adviser with the US Securities and Exchange Commission and as a Portfolio Manager with the securities regulatory authorities in Alberta, British Columbia, Manitoba, Nova Scotia, Ontario, Quebec and Saskatchewan. It provides asset management products and services to clients in the United States and Canada. Schroder Fund Advisors LLC ("SFA") markets certain investment vehicles for which SIMNA Inc. is an investment adviser. SFA is a wholly-owned subsidiary of SIMNA Inc. and is registered as a limited purpose broker-dealer with the Financial Industry Regulatory Authority and as an Exempt Market Dealer with the securities regulatory authorities in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Quebec, Saskatchewan, Newfoundland and Labrador. This document does not purport to provide investment advice and the information contained in this material is for informational purposes and not to engage in a trading activities. It does not purport to describe the business or affairs of any issuer and is not being provided for delivery to or review by any prospective purchaser so as to assist the prospective purchaser to make an investment decision in respect of securities being sold in a distribution. SIMNA Inc. and SFA are indirect, wholly-owned subsidiaries of Schroders plc, a UK public company with shares listed on the London Stock Exchange. Further information about Schroders can be found at www.schroders.com/us or www.schroders.com/ca.